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No. 169

IN THE

Supreme Court of the United States

OCTOBER TERM, 1960

POLAROID CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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ARGUMENT[1]

I

The legislative history does not support Respondent's contention that the word "discovery" in Section 456(a)(2)(B) applies only to the extractive industries.

Respondent's argument that the words "exploration", "discovery" and "prospecting", as used in Section 456(a)(2)(B), apply only to the extractive industries, is

1. The Brief for the Respondent refers for its principal arguments to the companion Brief for Petitioners in *Jarecki* v. *G. D. Searle & Co.*, No. 151. The latter brief will be referred to herein as the "Government's Brief in *Searle*". The so-called Korean War Excess Profits Tax Law and the Second World War excess profits tax law will be referred to herein as the "Korean War Act" and the "Second World War Act", respectively. All references to statutory provisions are to the Internal Revenue Code of 1939, unless otherwise expressly specified.

predicated upon the assumption that long before these words were used in Section 721(a)(2)(C) of the Second World War Act, the predecessor of Section 456(a)(2)(B), they had acquired a limited and specific meaning in the internal revenue laws as referring only to "natural resources" (Brief for the Respondent, p. 7).[2] The sole basis urged by Respondent for such assumption is a reference to two provisions, expressly dealing with mines, oil and gas wells, of the Revenue Act of 1918 (and later reenactments), in one of which (Section 337) the words "prospecting or exploration and discovery work" were used, and in the other (Section 234(a)(9)) the word "discovery" (Government's Brief in *Searle*, pp. 24-37).

It does not, however, follow from the use of these words in a clearly expressed context as applying only to "mines, oil or gas wells", that Congress intended these words to have the same restricted meaning when in Section 721(a)(2)(C) and Section 456(a)(2)(B) it used them generally without indicating by other phrasing any intention to limit their meaning to their extractive sense.

As we have stated in our Brief for the Petitioner (pp. 23-24), the original source of Section 456(a)(2)(B) was not Section 337 of the Revenue Act of 1918, as Respondent contends (Government's Brief in *Searle*, p. 28). The original source was Section 327 (d) of that Act, the

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2. It is not clear whether it is Respondent's contention that the words "exploration", "discovery", and "prospecting" apply only to mines, oil and gas wells or to all natural resources. Both positions appear to have been taken by Respondent (Compare, for example, the statement on page 35 of Government's Brief in *Searle* that these words have application "only to the mining, oil and gas industries" with frequent statements that such words apply to the natural resources industries generally (ibid. pp. 6, 7, 22, 32, 55)). In customary usage the limited, restricted meaning which Respondent attributes to these words does not have applicability to such a natural resource as timber. Thus, under Respondent's interpretation, even the timber industry would be ineligible for relief under Section 456(a)(2)(B).

section expressly designed to afford relief from hardship resulting from abnormal conditions affecting the income of a taxpayer in the taxable year, as well as hardship caused by abnormal conditions affecting its tax base.[3] The history of the evolution of Section 327 through the House, Senate and Conference Committee demonstrates that when used in provisions affording relief for abnormalities, the words "prospecting", "exploration" and "discovery" were not restricted in their meaning as referring only to the operations of the extractive industries.

The Revenue Act of 1918 originated in the House as H.R. 12863 (H.R. Rep. No. 767, 65th Cong., 2d Sess., September 3, 1918, 1939-1 Cum. Bull. (Part 2) 86). By Amendment No. 263 the Senate greatly expanded Section 327 of the House bill by including therein various classes of abnormal conditions which had not been mentioned in the original bill (H.R. Rep. No. 1037, 65th Cong., 3d Sess., February 6, 1919, 1939-1 Cum. Bull. (Part 2) 130, 149). When such section passed the Senate, it read, in part, as follows:

> "That in the following cases the tax shall be determined as provided in section 328:
>
> • • • • •
>
> (e) Where the invested capital is materially disproportionate to the net income as compared with

3. Respondent's contention (Government's Brief in *Searle*, p. 28, fn. 27) that Section 327(d) of the Revenue Act of 1918 was the precurser of Section 722 of the Second World War Act is only partially correct. In so far as it dealt with abnormal conditions affecting the tax base, it was the source of Section 722, and of Sections 442-447 of the Korean War Act, which likewise dealt with abnormalities in the base period. In so far as Section 327(d) dealt with abnormal conditions affecting income in the taxable year, it was the forerunner of Section 721 of the Second World War Act and Section 456 of the Korean War Act, which treated with abnormal income in the taxable year.

representative corporations engaged in a like or similar trade or business because:

* * * * *

3. The net income for the taxable year is abnormally high due to the realization in one year of (a) gains, profits or income earned or accrued during a period of years, or (b) *extraordinary gains or profits derived from the sale of property the principal value of which has been demonstrated by prospecting or exploration and discovery work done by the taxpayer* * * *" (Italics supplied). (1922-I-1 Cum. Bull. at 385, 386).

In the Conference Committee the language of the Section was materially altered, and it was finally passed in the form in which it appears in Section 327 of the Revenue Act of 1918 (Appendix to Brief for the Petitioner, pp. 24a-25a). But the language changes were intended only to amalgamate into a single, general classification the various classes of cases entitled to relief as set forth in the Senate version, and not to eliminate any of such classes (H.R. Rep. No. 1037, 65th Cong., 3d Sess., February 6, 1919, 1939-1 Cum. Bull. (Part 2) 130, 149). Thus, Senator Penrose stated:

"* * * Similar action was taken with respect to the so-called relief provisions, which permit the profits tax in any case of exceptional hardship to be fixed by reference to the experience of representative concerns. This amendment, to my mind, is a most admirable one. The Senate greatly increased the classes of cases entitled to this relief. The conferees amalgamated all these classes into a single general class * * *." (65th Cong. 3d Sess., February 12, 1919, 57 Cong. Rec. 3182; quoted in 1922-I-1 Cum. Bull. 383, 387).

Carl A. Mapes, Solicitor of Internal Revenue, in his opinion on the treatment of special cases under Section

327 (1922-I-1 Cum. Bull., 383, 388, 389) expressed the Congressional intent underlying this section as follows:

> "The above quoted statements indicate that Congress intended to retain the relief provisions of the Senate in the bill as finally passed, but that it intended to consolidate all the provisions into one general class. The Senate greatly increased the classes of cases entitled to this relief, and the conferees amalgamated all these classes into a single general class. A better idea may be gained of the relief intended, therefore, when a comparison is made of the bill as it passed the House, as it passed the Senate, and as it finally passed after conference. If all the classes of cases which were embodied in the bill as it passed the Senate were 'amalgamated' or 'consolidated' into one general class, we receive some idea of what was intended by use of the phrase 'abnormal conditions affecting the capital or income of the corporation' by referring to the bill as it passed the Senate • • •.
>
> The thought in the minds of those in charge of the bill was centered upon preventing inequalities and unjust discriminations. If the corporation's tax is high merely because it made large profits upon a normal invested capital, no relief is to be granted. If, however, owing to some abnormal condition affecting its business it is compelled to pay a higher rate of tax than other corporations in its class, then it may show that it is under the 'hardship of inequality' and gain relief under sections 327 and 328 • • •."

In implementation of this Congressional intent, the Solicitor of Internal Revenue ruled that a company which had spent large sums in "experimental and discovery work" for the development of a secret formula, which had not been capitalized, was entitled to relief under Section 327 (1922-I-1 Cum. Bull. 383, 384).

Among the various amendments proposed by the Senate to the House bill, in addition to the aforementioned

Amendment No. 263, amending Section 327, was Amendment No. 288 which introduced into the bill Section 337 (1939-1 Cum. Bull. (Part 2) at 159). As Respondent states, Section 337 was intended by the Senate to provide special relief to the mining, oil and gas industries only; and such intention was made clear, as we have stated, by the express reference to "mines, oil or gas wells" in that section. Had the Senate also intended a restricted application to the words "prospecting or exploration and discovery work" in Section 327, it would in the same way have made such intention clear by a similar reference. But in its amendment of the House's Section 327, the Senate made no such reference; on the contrary, it used the general word "property" in designating, as an abnormal condition, "extraordinary gains or profits derived from the sale of property the principal value of which has been demonstrated by prospecting or exploration and discovery work".

That the words "prospecting or exploration and discovery work", as used by the Senate in Section 327, were understood to apply to all types of industries is apparent from the action of the Conference Committee in amalgamating into one general class all of the classes of abnormal conditions set forth in the Senate version of Section 327. If these words, as there used, applied only to the mining, oil and gas industries, the class of abnormal condition to which they referred could not have been merged into the single general class of abnormal conditions applicable to taxpayers in all industries. Moreover, if the mining, oil and gas industries were intended as the only industries entitled to the benefits of the relief provisions relating to "prospecting or exploration and discovery work", in both Section 327 and Section 337, it is unlikely that such relief would have been split into two separate and unrelated sections.

We respectfully submit that the words "exploration", "discovery" and "prospecting" were similarly intended to have general meaning applicable to qualifying corporations in all industries, when they were repeated in Section 721(a)(2)(C) of the Second World War Act and Section 456(a)(2)(B) of the Korean War Act.

That such intent underlay Section 721 is apparent from the following colloquy on the Senate floor:

> "Mr. Adams: Where is the added benefit in this bill, then, to the mining industry?
>
> • • •
>
> Mr. George: Under this bill, which is entirely remedial, it is permissible to go back 10 years, or even further than that. It is permissible to go back through the whole period of development; and in that way the bill is helpful to the mining industry. *It is not helpful to the mining industry alone. It is helpful to any type of corporation;* but it does result in very great benefit to the particular lines of industry that have a development reaching back over a period of time.
>
> Another thing the amendment does is that various hardship cases are relieved. *Many of them would be mining companies as well as other companies;* but particularly the period through which the cost of development may be spread goes back further than the amendment which was carried to conference. It may go back through the whole period of development. • • •
>
> • • •
>
> Mr. Adams: I was thinking not alone of mining companies. The bill applies equally to an inventor.
>
> Mr. George: It applies to all.
>
> Mr. Adams: It applies to a man who was working on an invention over a period of years, spending his resources, and finally accomplishing his purpose.
>
> Mr. George: The Senator is correct. *It applies to all equally. It applies to every corporation,*

regardless of the kind of business it is doing." (Italics supplied.) (77th Cong., 1st Sess., March 3, 1941, 87 Cong. Rec. 1636, 1637.)

A similar intention, we submit, of providing relief for abnormal income of the class described in Section 456(a)(2)(B) for "any type of corporation", motivated Congress in the enactment of that subsection. The word "discovery", as there used, had the same meaning as in Section 721(a)(2)(C), and in the Senate version of the section which became Section 327(d) of the Revenue Act of 1918.[4] The omission from Section 456(a)(2)(B) of the words "research, or development of tangible property", which had been in Section 721(a)(2)(C), did not change the meaning of "discovery".

It is a well recognized principle of statutory construction that striking one part of a statute does not thereby alter the meaning of the remainder. *United States* v. *Radio Corporation of America*, 358 U. S. 334, 343, 344 (1958); *United States* v. *Dickerson*, 310 U. S. 554, 561 (1940).

Moreover, the Committee reports explaining the motivation for the deletion of these words do not suggest any intention to alter the purport of the words which were retained. Had Congress intended so drastic a measure as to deny relief, under any and all circumstances, to all industries other than the extractive industries, for abnormal income resulting from their pioneer discoveries —a form of relief available to all industries under both previous excess profits tax laws—it would be expected that the Congressional reports would have clearly so stated. We submit, as we shall demonstrate in Point II hereof, that Congress did not intend so sweeping a change.

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4. Respondent concedes that "discovery" in Section 456(a)(2)-(B) has the same meaning as in Section 721(a)(2)(C) (Government's Brief in *Scarle*, pp. 15-16).

II

Respondent has misconstrued the Congressional Committee Reports as to the effect intended by the omission from Section 456(a)(2)(B) of the words "research, or development of tangible property" used in Section 721(a)(2)(C) of the Second World War Act.

Respondent's argument that the deletion of "research, or development of tangible property" had the effect of barring relief for abnormal income resulting from the sale of tangible property arising out of any and all scientific discoveries (Government's Brief in *Searle*, pp. 16-17) is based upon an improper interpretation of the Committee Reports.[5]

The Committee Reports stated that the reason for such deletion was to plug "a potential loophole" found to exist in the old law. We respectfully suggest that such potential loophole stemmed from the uncertainty, in various cases brought under the research and development provisions of Section 721(a)(2)(C), as to what portion, if any, of the taxpayer's income in the taxable year was the direct result of the special demand for the particular product arising from the taxpayer's alleged research and development. *Keystone Macaroni Manufacturing Co.* v. *Commissioner of Internal Revenue*, 18 T.C. 1078 (1952); *Atlumor Manufacturing Co., Inc.* v. *Commissioner of Internal Revenue*, 12 T.C. 949 (1949); *Eitel-McCullough, Inc.* v. *Commissioner of Internal Revenue*, 9 T.C. 1132 (1947).

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5. H.R. Rep. No. 3142, 81st Cong., 2d Sess., December 2, 1950, 1951-1 Cum. Bull. 187, 195; Senate Rep. No. 2679, 81st Cong., 2d Sess., December 18, 1950, 1951-1 Cum. Bull. 240, 249.

As we have demonstrated in our Brief for the Petitioner (p. 25), in the case of the discovery of a new basic invention, no potential loophole could exist since, but for the discovery, there would have been no income at all from such source. We submit that since granting a right to relief for such a discovery could not result in any potential loophole, Congress had no intention of barring it from relief under Section 456.

It was, we urge, only the difficulty of directly relating the income to the research and development in cases not involving invention in the order of discovery, with which Congress was concerned, and not, as Respondent contends (Government's Brief in *Searle*, pp. 47-48), the problem of adjusting the quantum of relief for improved business conditions or other external factors, which may have contributed to the taxpayer's income in the taxable year.[6] These external factors affected the income of mining companies as well as companies in other fields, and appropriate adjustments therefor were made in computing net abnormal income in cases qualifying for relief under Section 721(a)(2)(C). See *Simpson Richey* v. *Commis-*

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6. *Ibid.* The Committees' express reference only to avoiding "the *introduction* of a large degree of administrative discretion of the type required by the general relief clause of the World War II law (Section 722)" [italics supplied], suggests that Congress was not particularly disturbed by any administrative discretions which had been required under Section 721. This is confirmed by the repetition in Section 456 in virtually identical language of the provisions of Section 721 for computation of net abnormal income and its attribution to other years (Brief for the Petitioner, p. 26).

We respectfully urge that the administrative discretion regarded by the Committees as undesirable and unfeasible was an administrative discretion directed to a construction of the income resulting from the alleged research and development, when the actual income from such source was unascertainable. Such an administrative discretion would have been of the type which had been required under Section 722 in determining the constructive average base period net income (Government's Brief in *Searle*, p. 40).

sioner of Internal Revenue, 19 T.C. 926, 933 (1953) (mining company); *W. B. Knight Machinery Company* v. *Commissioner of Internal Revenue*, 6 T.C. 519 (1946); *Rochester Button Company* v. *Commissioner of Internal Revenue*, 7 T.C. 529 (1946); *Ramsey Accessories Manufacturing Corporation* v. *Commissioner of Internal Revenue*, 10 T.C. 482 (1948); *Keystone Brass Works* v. *Commissioner of Internal Revenue*, 12 T.C. 618 (1949) (industrial companies).

Such adjustments are still to be made under Section 456, as is apparent from the retention of the following provision in Section 40.456-3(b) of the Regulations:

> "• • • To the extent that any items of net abnormal income in the taxable year are the result of such factors as high prices, low operating costs, increased demand, or decreased competition, such items shall not be attributed to other taxable years • • •." (Treasury Regulations 130 (1951), Section 40.456-3(b)).

In the present case, if Petitioner is successful herein, the amount of net abnormal income resulting from Petitioner's discoveries and the respective amounts thereof to be attributed to the prior years, have been agreed upon by stipulation (R. 57-58, fols. 62-63).

We respectfully submit that a proper interpretation of the Committee Reports supports the conclusion expressed in our Brief for the Petitioner that the deletion of "research, or development of tangible property" did not affect Petitioner's right to relief under Section 456 for its discovery income.

CONCLUSION

It is respectfully submitted that the judgment of the Court below should be reversed and the case remanded to the Tax Court for the fixing of Petitioner's net abnormal income and the attribution thereof to prior years, in accordance with the stipulation herein.

Dated: February 7, 1961.

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